THE BOND BUYER

THE DAILY NEWSPAPER OF PUBLIC FINANCE

Moody's Likes Virginia Pension Fix, But Not Maryland's Budget Cutting

Wednesday, April 18, 2012

By Kyle Glazier

WASHINGTON – Virginia won applause from Moody's Investors Service this week following an overhaul of its pension system, but neighboring Maryland received flak as the credit rating agency warned its proposed budget cuts could harm the credit of local governments.

While both states are among just eight to hold triple-A ratings from all three major rating agencies, and both are on negative outlooks due to their close economic ties to the cash-strapped federal government in Washington, D.C., Moody's analysts took divergent views on major actions the two states have taken in the past weeks.

Virginia Gov. Robert McDonnell signed into law a sweeping overhaul of the commonwealth's pension system last week, reducing pension contributions by $3.6 billion over the next 21 years.

The law does away with the current defined benefit plan and establishes a hybrid pension/401(k)-style contribution plan for new state and local employees, reducing benefits for certain state employees.

Additionally, cost-of-living adjustments for employees with fewer than 20 years of service who retire early are deferred under the new legislation until what would have been their normal retirement date.

A mandatory switch to the new hybrid plan is slated to take effect on Jan. 1, 2014.

The overhaul – which McDonnell, Treasurer Manju Ganeriwala and other state officials have cited as a top priority – puts Virginia "on a more sustainable path to fully funding its pension commitments, which is credit positive," Moody's senior analyst Lisa Heller said in a report issued Monday.

Virginia's actions mirror a national trend, Heller noted, as states seek to fund pension obligations that are on track to conflict with other obligations, such as paying bondholders.

"It is essential in bending the long-term cost curve for Virginia," said state Finance Secretary Ric Brown.

A March study by the nonpartisan Government Accountability Office found that since 2008, at least 18 states have passed legislation effecting cost-of-living adjustments and 38 states have enacted laws altering other aspects of their pension systems.

However, neighboring Maryland's proposed 2013 budget and new legislation restricting the ability of municipalities to cut education spending drew a different reaction, with Moody's associate analyst Jennifer Diercksen labeling the moves potentially "credit negative for local governments."

The budget was approved last week by the Maryland General Assembly but has not yet been signed into law by Gov. Martin O'Malley.

The spending plan would cut state aid payments to Maryland's 23 counties and the city of Baltimore by about $262 million in fiscal 2013.

"The cuts, on average, are only 1.7% of county's budgets," Diercksen's analysis states, "but new state legislation approved by the governor on April 10 restricting local governments' ability to reduce their education spending exacerbates the financial effect."

That law requires localities to continue funding K-12 education at the same level as the prior year. If they fail to do so, the state now has the ability to withhold income tax revenues from them and pass some of the funds directly to local school boards.

Diercksen's analysis is contingent on O'Malley signing the budget as it exists, which he may not do.

The governor has the ability to call a special legislative session to work out a new budget agreement, but has not yet publicly committed either way.

O'Malley spokeswoman Raquel Guillory said there is currently no date set for a budget resolution.